No. 12850.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JOSEPH G. WHITE,

Appellant,

vs.

FRANCIS F. QUITTNER, Trustee in Bankruptcy in the Estate of Al Herd, Bankrupt,

Appellee.

APPELLANT'S REPLY BRIEF.

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TABLE OF AUTHORITIES CITED

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For convenience of court, and to be consistent with Appellant's Opening Brief, Appellant is hereinafter referred to as "White" and Appellee as "the Trustee".

The Trustee's Statement of the Case.

Neither White nor the Trustee has questioned the sufficiency of the evidence to sustain the findings of fact of the court below, and a statement of the case must, therefore, be based on the facts found. The Trustee has based his statement on evidentiary matter rather than on the findings and sets forth evidence and argument contrary to the findings. Although the Trustee has designated White's statement of the case as "distorted" and "incomplete", White's statement is based entirely on the findings and the use of such designations is not warranted.

It might be added that since neither White nor the Trustee have made exceptions to the findings there was no need to print the voluminous testimony heard below, and the cost of printing such testimony should be borne by the Trustee, who requested it.

The Trustee objects to White's designation of the Trustee's concealment of his interest as "wrongful". The designation is based on the following findings and conclusions of the court below.

> "The Trustee, so as to avoid affording Respondent [White] an opportunity to assert possible claims which might have been assertable against the Trustee but not against Gibbons, did not disclose to Respondent the interest of the Trustee in said $5000.00 note or in the aforesaid promissory note action." [Finding of Fact V.]
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> "That on or about July 15, 1948, Messrs. Wellins and Weber, *ostensibly as attorneys for plaintiff, George L. Gibbons, but actually as attorneys for the Trustee herein,* filed a motion for summary judgment in said promissory note action. . . ." [Finding of Fact IX.] (Emphasis supplied.)
>
> "That on or about June 16, 1948, an order was made by the Referee in Bankruptcy herein, authorizing said substitution of attorneys [of Weber and Wellins as attorneys for Gibbons in the place and stead of Jones and Weiner] . . . and the original of said substitution of attorneys . . . was filed in the office of the County Clerk of Los Angeles County on July 19, 1948. At all times Marvin Wellins and Daniel A. Weber represented the Trustee herein in said promissory note action and did not at any time represent George L. Gibbons, the original plaintiff in said action." [Finding of Fact VII.]

"The Trustee herein was the real party in interest as party plaintiff in the action entitled Gibbons v. White. . . . The Trustee's failure to disclose his interest in said action prevented Respondent herein [White] from asserting any offsets, defenses or claims which may have existed in his favor against the Trustee, *and Respondent was entitled to have an opportunity to assert said offsets, defenses and/or claims.*" [Conclusion of Law I.] (Emphasis supplied.)

The Trustee's "Purchase" of the Gibbon's Note.

Finding of Fact V-A [Tr. p. 37] declares that the note was "acquired" by the Trustee after bankruptcy for a valuable consideration. That consideration is described in Finding V [Tr. p. 36] and Finding VIII [Tr. p. 38] as a release of the claims asserted by the Trustee in his usury action against Gibbons.

Whether this was a purchase of the note or a discharge of the note depends on whether the Trustee was a party liable thereon or a stranger thereto, as discussed on page 15 and following of White's opening brief. The Trustee points out that under various circumstances a Trustee stands in a better position than does the bankrupt. However, he does not show why, in prosecuting his action against Gibbons and compromising it, he stood in any better position than the bankrupt. That action was based on a claim of usury assertable by the bankrupt and the Trustee could not assert that claim, as the Trustee implies, under any rights given him as a judgment creditor or as the operator of a business for the benefit of the estate. The Trustee could assert that right only by virtue of his succeeding to the interest of the bankrupt. Furthermore,

the facts are that the note in question was given to Gibbons in payment of the usurious loan at a time when the bankrupt erroneously supposed that he was indebted to Gibbons. Under such circumstances, the bankrupt, as the accommodated party on the note, was entitled to prevent negotiation of the note and to its cancellation. This well-known equity rule is codified in California Civil Code, Section 3412 as follows:

> "When Cancellation May Be Ordered. A written instrument, in respect to which there is a reasonable apprehension that if left outstanding it may cause serious injury to a person against whom it is void or voidable, may, upon his application, be so adjudged, and ordered to be delivered up or cancelled."

Herd's right to delivery or cancellation of the note passed to the Trustee along with Herd's other assets. Under such circumstances, can the Trustee be allowed to "purchase" the note by settling the bankrupt's claim against Gibbons and, thus, be allowed to do that which no creditor of the bankrupt could do, and that which the bankrupt could not do? When the Trustee settled with Gibbons and acquired the note, he was simply doing what it was the duty of the bankrupt to do; that is, to acquire the note and hold White harmless in the transaction. The Trustee's statement that he "was certainly under no obligation to use estate assets to purchase or acquire the note from Gibbons" assumes that the Trustee took Herd's assets free and clear of Herd's liabilities and obligations. This assumption is contrary to the law. As is pointed out in the authorities cited by White in his opening brief on page 9, the rule is that the Trustee takes the bankrupt's property subject to the equities.

The Trustee's Argument Concerning Recoupment.

The Trustee asserts that the date of filing the petition is the date of "cleavage" in determining the right of recoupment against a trustee, so that a claim arising before bankruptcy cannot be urged where a trustee asserts a right arising after bankruptcy. No authority is cited which sustains this position. The Trustee has cited many cases on this point, but none of them deal with recoupment.

The Trustee seeks to distinguish the case of *Howard Johnson v. Tucker,* 157 F. 2d 959, cited by White, on the ground that there the trustee was seeking to enforce a right which the bankrupt held at the time of bankruptcy. First it may be noted that the court there allowed recoupment on account of claims for rent arising both before and after bankruptcy, so that certainly there can be no rule that the claim urged in recoupment must arise either before or after bankruptcy, or that the claim urged in recoupment must arise at the same time as the claim urged by the trustee. It must also be noted that there the trustee sought an accounting for the proceeds of a check which was cashed not before, but after bankruptcy, and that the claim asserted by the Trustee was one which arose after bankruptcy. The court there did not draw distinctions based on technicalities but made its decision on the equity and justice of settling all claims which arose out of the transaction upon which the trustee's claim was based.

Furthermore, as has been pointed out, the bankrupt here had a right to secure the return of the note from Gibbons which right passed to the Trustee at the time of bankruptcy.

In this connection it is interesting to note that even in case of set-off, courts of equity will not be bound by technical requirements of mutuality if equity and fair dealing requires:

> "A limitation of the right of setoff to cases of mutual credits is not necessarily controlling in equity, *even though the suit is one by a trustee in bankruptcy*. A setoff is permissible, under general principles of equity, to prevent injustice, even though the debts are not strictly mutual. Trustees of a bankrupt estate, who, with knowledge of the bank as to their source, deposit funds of the estate, available for the payment of claims in a bank which holds a note against the bankrupt, may, in case the bank becomes insolvent, set off the deposit account against the claim for what remains due on the note."
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> 6 Am. Jur. 853, Sec. 517.

> "Although as a general rule, equity, following the law, will not allow a setoff of debts accruing in different rights, it is well settled that a court of equity will take cognizance of cross claims between litigants, even though wanting in mutuality, and set off one against the other whenever it becomes necessary to effect a clear equity or prevent irremediable injustice."
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> 47 Am. Jur. 747, Sec. 49.

Conclusion.

The Trustee presents no compelling reason or authority for White's being forced to pay the Trustee on the note here in question, which note represented a supposed obligation of the bankrupt to a third party which the Trustee established as being non-existent.

Respectfully submitted,

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